

# Federal Tax Incentives for the Rehabilitation of Historic Buildings

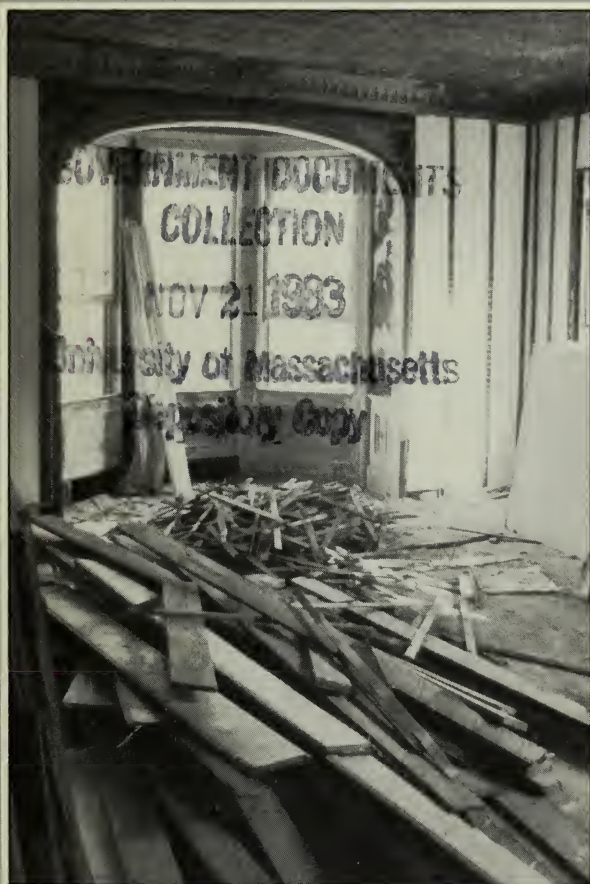
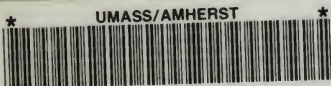


Photo: Jack Cascio



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MASSACHUSETTS  
HISTORICAL  
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A division of the  
Department of the State Secretary,  
Michael Joseph Connolly, Secretary of State

# Introduction

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The prospects for the preservation of historic buildings have brightened greatly with the passage of the long-awaited code revisions provided by the Tax Reform Act of 1976.

Because of those revisions, the Internal Revenue Code now reflects the intent of the National Historic Preservation Act of 1966: the rehabilitation of historic buildings is given the same tax treatment as new construction. In addition, the Act disallows certain preferential tax treatments for new commercial construction on the site of sound historic structures. Thus, substantial tax incentives have been created for citizens to assist in the preservation of our nation's rich diversity of historic resources.

Specifically, the owner of a historic building is allowed *accelerated* depreciation for approved rehabilitation of a qualified building. Theoretically, the value of improvements declines yearly, and the loss of value is allowed as a tax deduction. Through accelerated depreciation, the property owner recovers the investment faster through larger, earlier tax deductions.

This tax "shelter" is marketable, and is often used to attract funding to a project. However, should the property be sold too soon after the incentives have been taken advantage of, the IRS, pursuant to the Act, can "recapture" some of the benefits. (This recapture provision was clarified in the Revenue Act of 1978.)

These new tax incentives are available only to owners of *income producing* properties; ordinarily, private homeowners are not eligible.\*

*\*Since tax matters can be complex, it is advisable to seek the guidance of an attorney or an accountant in order to take full advantage of the benefits offered under the Tax Reform Act.*



*Detail, R.H. Stearns Building,  
Boston*

# Some Basic Terms

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*The National Register of Historic Places*, maintained by the Secretary of Interior, is a list of important cultural resources. Listings include objects, structures, archaeological sites, buildings, and districts. Properties listed are significant locally, regionally, or nationally in American archaeology, history, engineering or architecture.

Nominations to the Register are made in each state by the State Historic Review Board and the State Historic Preservation Officer (SHPO). In Massachusetts these are the Massachusetts Historical Commission (MHC) and the Executive Director of the MHC, respectively.

A listing of National Register properties is published annually in the first Tuesday of the February edition of the *Federal Register*, generally available in public libraries. Because properties are added to the National Register regularly, the MHC should be contacted to determine if a property has been listed after publication of the last annual listing in the *Federal Register*.

*A Certified Local Historic District* is a local historic district that has been certified by the Secretary of Interior as substantially meeting the National Register Criteria for Evaluation. The Secretary must also find that the statute provides sufficient protection for the district's character and significance. In Massachusetts, local historic districts are established under the provisions of Chapter 40C of the General Laws or under special enabling legislation. Historic districts are administered by commissions composed of qualified professionals and residents of the district who determine the appropriateness of alteration to exteriors. The local district commission and the MHC may verify records of the certification of particular local historic district statutes.

*A Certified Rehabilitation* is a complete program of work rehabilitation of an historic structure either for its original use or a new compatible use. The completed work must be in conformance with the Secretary of Interior's Standards For Rehabilitation. The MHC and the Department of Interior review applications to determine if the work is acceptable.

# The Tax Incentives

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Section 2124 of the Tax Reform Act of 1976 provides the owner of a Certified Historic Structure who undertakes a Certified Rehabilitation with a choice of two options for preferential tax treatment:

The *first option* allows the owner to amortize (write off) the costs of the rehabilitation over five years. This write off usually includes all costs associated with the work, including professional fees.

The *second option* is applicable when the cost of the rehabilitation exceeds \$5,000, or is more than the "adjusted basis" of the property (the value of the building alone without the land). In this case, the owner can combine the costs of rehabilitation with the "adjusted basis" and take accelerated depreciation.

Each building has a theoretical useful life span, and, for tax purposes, its value is depleted at the end of that span. The paper "loss" in value each year is allowed as a tax deduction. For example, under ordinary or *straight line depreciation*, if an office building has a "useable life" of twenty years, the owner may deduct 1/20th of its value every year for twenty years. If the property qualifies for *accelerated* depreciation, the owner may deduct 1/20th of *one and a half* times its value each year until the value of the useful life is depleted. In this way, the owner recovers the investment quicker.

To qualify for these benefits, the property must be income-generating and the work must be approved, undertaken, and completed between June of 1976 and June of 1981. It is possible that Congress will extend these benefits for an additional five years, but no such action on an extension has yet been taken.

Another incentive, a 10% investment credit, is provided by the Revenue Act of 1978. Ten per cent of the rehabilitation costs can be deducted, not from taxable income, but directly from taxes due. This deduction can be taken only once, and it is applicable to any income-producing building in use for twenty years or more. It can be used in conjunction with accelerated depreciation for Certified Historical Structures.

## *Which buildings qualify for incentives?*

All buildings in use for twenty years or more might qualify for the 10% investment credit under the Revenue Act. If the property is not historic, no special review or approval is required.

Rapid Amortization and Accelerated Depreciation, like other federal aids and incentives for preservation, is available only to properties listed in or pending listing in the National Register of Historic Places. In the nomenclature of the Tax Act, eligible properties are referred to as Certified Historic Structures. This includes all properties listed in the National Register,



properties listed in the Register within historic districts, and properties that contribute to the significance of Certified Local Historic Districts. When a property is listed as a part of an historic district, the property must be evaluated and found to contribute to the significant or historic character of the district, in order to qualify for tax benefits.

### *What if a property does not qualify now?*

If a property does not presently qualify as a Certified Historic Structure and the owner believes that it could, the Massachusetts Historical Commission (MHC) should be contacted directly.

The Massachusetts Historical Commission nominates properties to the National Register based on a comprehensive survey conducted by local historical commissions and other local preservation groups according to MHC survey standards. Properties of state and national significance are often nominated directly by the MHC.

If, in the opinion of the State Historic Preservation Officer, a property appears eligible for National Register listing, the owner, at his/her own risk, can have the project work reviewed. This is helpful if work on the project is scheduled to begin soon. Such an evaluation does not allow an owner to partake of the tax advantages immediately, but would allow the work to commence. When the property is listed in the National Register, no further review will be necessary before the owner claims deductions. Certification will follow completion of the work.

## The Disincentives

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The National Historic Preservation Act of 1966 established a federal policy which identifies historic resources and protects them from demolition to make room for public projects. However, the Tax Code still allowed preferential treatment for new construction even when it required the demolition of a federally-recognized historic building.

The Tax Reform Act of 1976 corrected this conflict. Today, should an owner destroy a sound Certified Historic Structure for new commercial construction, preferential tax treatment (accelerated depreciation) is denied. Of course, the owner still qualifies for regular tax deduction (straight line depreciation). Further, demolition costs can not be deducted as a business expense, and the cost of the demolition must be added to the value of the land. Therefore, the tax basis of the land is adjusted upward in value.

These disincentives do not take away a property owner's right to normal treatment under the tax code, but they do deny preferential treatment. They are an example of the government's power to influence actions through incentives and disincentives.

# How a Building and its Are Certified

Only owners of record may apply for certified rehabilitation. Application can be made before, during or after completion of the work. It is advisable, however, to apply before the work begins. Early review of the project can identify elements inconsistent with the Standards for Rehabilitation. It also accurately establishes the nature and extent of the rehabilitation work.

A two part application for certified rehabilitation is available from the Massachusetts Historical Commission. The application consists of the following:

## *Part One: Certifying the Structure*

(An owner whose property is listed on the National Register individually is not required to complete Part One.) If the structure is within a National Register district, this part requests appropriate information (description, structural history, and a statement of the building's significance to the district) to evaluate its eligibility for status as a Certified Historic Structure.

## *Part Two: Review of the Proposed Work:*

The proposed rehabilitation work is described by employing appropriate background information (structural history, building condition, etc.), narrative and graphics (photos, plans, etc.). This material should accurately present the proposed work and its impact on



*Old Market House*

# Rehabilitation

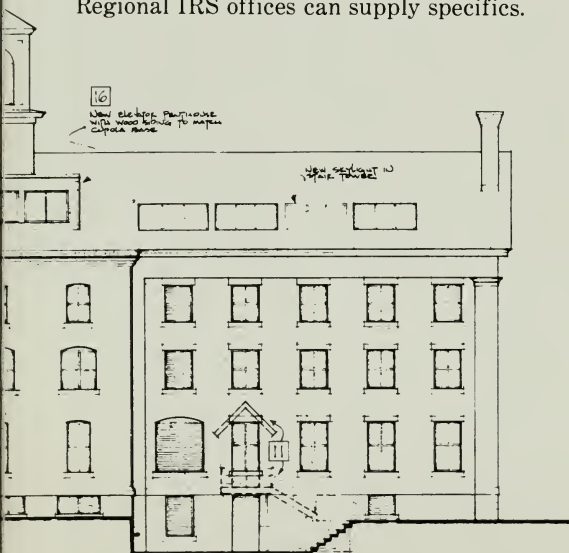
the historic fabric (original materials, decorative features, distinguishing or original characteristics) of the structure.

Before completing Part Two, it is advisable to meet with the MHC staff to review the work and presentation format.

The completed application is submitted to the MHC, where it is reviewed and then forwarded, with the SHPO's recommendations, to the Department of Interior for final review and determination. Owners are notified directly of the decision of the Secretary of the Interior. (If it is necessary to alter the proposed work during construction, the MHC should be contacted.)

A certificate of rehabilitation will be awarded only at the completion of the project, after the owner has certified in writing that the work was done in accordance with the approved program. The owner must submit photos of the completed work. A site visit might also be made by a MHC staff member. A certificate may not be awarded if the owner fails to undertake the project according to the work program approved by the Secretary of Interior.

This certificate is the prerequisite for the tax benefits. Temporary IRS regulations were published in the April 6, 1977 issue of the Federal Register. Regional IRS offices can supply specifics.



# Standards

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## *Secretary of Interior's Standards for Rehabilitation*

*Federal Register* 36 CFR 67.7

10/7/77

1. Every reasonable effort shall be made to provide a compatible use for a property which requires minimal alterations of the building, structure, or site and its environment, or to use a property for its originally intended purpose.
2. The distinguishing original qualities or character of a building, structure or site and its environment shall not be destroyed. The removal or alteration of any historic material or distinctive architectural features should be avoided when possible.
3. All buildings, structures and sites shall be recognized as products of their own time. Alterations that have no historical basis and which seek to create an earlier appearance shall be discouraged.
4. Changes which may have taken place in the course of time are evidence of the history and development of a building, structure or site and its environment. These changes may have acquired significance in their own right, and this significance shall be recognized and respected.
5. Distinctive stylistic features or examples of skilled craftsmanship which characterize a building, structure or site shall be treated with sensitivity.
6. Deteriorated architectural features shall be repaired rather than replaced, whenever possible. In the event replacement is necessary, the new material should match the material being replaced in composition, design, color, texture and other visual qualities. Repair or replacement of missing architectural features should be based on accurate duplications rather than on conjectural designs or the availability of different architectural elements from other buildings or structures.
7. The surface cleaning of structures shall be undertaken with the gentlest means possible. Sandblasting and other cleaning methods that will damage the historic building materials shall not be undertaken.
8. Every reasonable effort shall be made to protect and preserve archaeological resources affected by or adjacent to any rehabilitation project.
9. Contemporary design for alterations and additions to existing properties shall not be discouraged when such alterations and additions do not destroy significant historical, architectural or cultural material, and such design is compatible with the



size, scale, color, material, and character of the property, neighborhood or environment.

10. Wherever possible, new additions or alterations to structure shall be done in such a manner that if such additions or alterations were to be removed in the future, the essential form and integrity of the structure would be unimpaired.



*Chadwick Lead Works, Boston*

# Summary of Requirements and Procedures

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1. The property qualifies as income producing (refer to IRC section 167, Code of 1954).
2. The property is listed in the National Register individually, as a significant part of a National Register Historic District, or is located in a Certified Local Historic District.
3. An application is made for status as a Certified Historic Structure.
4. The property is not now listed, but the SHPO believes it is eligible. Procedures are begun to nominate the property to the National Register.
5. The proposed work is reviewed with MHC staff.
6. The description of proposed work is completed and submitted to the MHC who then submits it to Washington.
7. Tentative approval of proposed work is received from Washington.
8. Project work is completed and documentation submitted to MHC.
9. MHC requests that Washington issue Certificate of Rehabilitation.
10. Certification is received.

For more information about eligible properties, the preparation of tax certification forms, and other preservation matters, please contact: Massachusetts Historical Commission, 294 Washington Street, Boston, MA 02108. (617) 727-8470



Department of the State Secretary  
Michael Joseph Connolly, Secretary of State

*This brochure has been funded with the assistance of a matching grant-in-aid from the Department of the Interior, Heritage Conservation and Recreation Service, under the provisions of the National Historic Preservation Act of 1966.*